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DAVID KAYNE

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION -- E-FILING

DAVID KAYNE, an individual citizen
of Georgia,

Plaintiff,

vs.

THE THOMAS KINKADE COMPANY,
formerly known as MEDIA ARTS
GROUP, INC., a Delaware Corporation,

Defendant.

Case No. C 07-4721 JF (RS)

**NOTICE OF MOTION AND
MOTION FOR TEMPORARY
RESTRAINING ORDER AND
PRELIMINARY INJUNCTION;
BRIEF IN SUPPORT OF MOTION**

**Hearing Date: October 5, 2007
Time: 9:00 a.m.
Courtroom: 3, 5th Floor**

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PLAINTIFF'S MOTION AND BRIEF IN SUPPORT
OF T.R.O AND PRELIMINARY INJUNCTION

CASE NO. C 07-4721 JF (RS)

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UNITED STATES DISTRICT COURT
 NORTHERN DISTRICT OF CALIFORNIA
 SAN JOSE DIVISION -- E-FILING

DAVID KAYNE, an individual citizen of Georgia,)	Case No. C 07-4721 JF (RS)
)	
Plaintiff,)	NOTICE OF MOTION AND
)	MOTION FOR TEMPORARY
vs.)	RESTRAINING ORDER AND
)	PRELIMINARY INJUNCTION;
)	BRIEF IN SUPPORT OF MOTION
THE THOMAS KINKADE COMPANY,)	
formerly known as MEDIA ARTS)	Hearing Date: October 5, 2007¹
GROUP, INC., a Delaware Corporation,)	Time: 9:00 a.m.
)	Courtroom: 3, 5th Floor
Defendant.)	

**Notice of Motion: TO DEFENDANT THE THOMAS KINKADE
 COMPANY ("TKC") AND ITS ATTORNEYS OF RECORD: PLEASE TAKE
 NOTICE THAT,** on October 5, 2007 at 9:00 a.m., or as soon thereafter as counsel
 may be heard by the Court, at Courtroom 3 (5th floor) of the United States
 Courthouse in San Jose, which is located at 280 South 1st Street, San Jose,
 California, 95113, plaintiff David Kayne will (and hereby does) move for the

¹ Pursuant to Local Rule 6-3 and the accompanying separate Motion To
 Shorten Time, plaintiff is seeking a hearing of this matter on October 5, 2007, or on
 such other date as the Court may set between now and October 15, 2007. This
 motion seeks to enjoin defendant from proceeding with an "expedited arbitration"
 hearing set to occur on October 16, 2007, in which plaintiff would be precluded from
 calling any witnesses or conducting discovery.

1 following relief: A temporary restraining order and preliminary injunction enjoining
2 TKC from proceeding further with, and from attending, the October 16, 2007
3 arbitration presently pending before the American Arbitration Association, entitled
4 *The Thomas Kinkade Company v. David Kayne* (AAA No. 74-181-E-000733-06), or
5 any other arbitral proceeding pursuant to the "expedited" arbitration procedure set
6 out in Exhibit "A" to plaintiff's complaint herein, until further order of this Court.

7 **PLEASE TAKE FURTHER NOTICE** that this motion is and will be based on the
8 following accompanying pleadings filed concurrently with this Notice, together with
9 such responsive and reply pleadings as may hereafter be filed, the Complaint on file
10 herein, and such other matters as may properly come before the Court at or in
11 connection with the hearing of this motion: (1) The brief memorandum of points and
12 authorities that follows this notice; (2) The Declaration of David Kayne in support
13 of this motion and exhibits attached thereto; (3) The Declaration of Charles L.
14 Coleman, III in support of this motion and exhibits attached thereto; (4) The
15 Certificate of Service of the summons, complaint and other documents (Local Rule
16 5-6); (5) The [Proposed] Temporary Restraining Order; (6) The [Proposed]
17 Preliminary Injunction; (7) The accompanying Motion To Shorten Time for hearing
18 of this motion (Local Rule 6-3); (8) The Declaration of Charles L. Coleman, III in
19 support of the Motion To Shorten Time; and (9) The [Proposed] Order Shortening
20 Time to respond to this motion.

21 **Statement of Relief Requested:** By this motion and the accompanying
22 Motion To Shorten Time, plaintiff David Kayne ("Mr. Kayne") seeks a temporary
23 restraining order and preliminary injunction to prevent defendant TKC from
24 proceeding further with a purported "expedited" arbitration procedure under which
25 it is seeking to conduct an arbitration "hearing" without affording Mr. Kayne the
26 right to call witnesses or conduct discovery, even though Mr. Kayne disputes TKC's
27 claim and even though TKC's claim is for an amount in excess of \$1.15 million. As

1 is more fully set out below, Mr. Kayne submits that TKC's purported "expedited"
 2 arbitration clause is unconscionable and violative of the principles recently
 3 announced in *Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006) (*en banc*),
 4 *Davis v. O'Melveny & Myers LLC*, 485 F.3d 1066, 1071 (9th Cir. 2007) and other
 5 recent cases holding that it is for the courts to determine whether an arbitration
 6 clause is unconscionable. For the reasons set out below and in the accompanying
 7 declarations, the "expedited" arbitration procedure that TKC seeks to implement on
 8 October 16, 2007 is unconscionable and should be enjoined.

9 **MEMORANDUM OF POINTS AND AUTHORITIES**

10 **I. STATEMENT OF ISSUES TO BE DECIDED:**

11 **A. Unconscionable "arbitration" clause:** Whether the "expedited"
 12 arbitration procedure described in an "Application for Credit" drafted by TKC is
 13 unconscionable under the standards recently articulated in *Nagrampa v. Mailcoups,*
 14 *Inc.*, 469 F.3d 1257 (9th Cir. 2006) (*en banc*) and other recent cases, where: (a) The
 15 "Application for Credit" and accompanying "Personal Guaranty" was a contract of
 16 adhesion presented to Mr. Kayne in circumstances giving rise to procedural
 17 unconscionability; (b) In presenting its agreements to plaintiff David Kayne, TKC
 18 was required to, but did not, comply with the disclosure requirements of California
 19 and federal franchise laws; (c) The AAA "expedited" arbitration procedure
 20 referenced in TKC's agreement was designed and intended for disputes less than
 21 \$75,000, whereas TKC now seeks to use this procedure to demand over \$1.15
 22 million from Mr. Kayne; (d) TKC's standard arbitration agreement even purports to
 23 further restrict Mr. Kayne's hearing rights beyond what is contemplated in the AAA
 24 "Expedited" Rules for disputes less than \$10,000 by providing that no discovery may
 25 be conducted and that the parties "*waive all right to any hearing requiring witness*
 26 *production*"; (e) TKC's agreement would require that Mr. Kayne (a small business
 27 owner located in the Buford, Georgia with no businesses in California) to defend
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1 against TKC's "expedited" arbitration hearing in Santa Clara County, California;
2 and (f) Mr. Kayne would not be able to present his defenses to TKC's claims without
3 discovery or the right to call and cross-examine live witnesses. [Answer: YES].

4 **B. TKC's Anticipated Defenses:** Plaintiff anticipates that TKC's
5 defenses to his claims will seek to divert attention from the clear unconscionability
6 of its "expedited" arbitration clause by focusing instead on the following issue
7 expected to be raised in TKC's anticipated motion due to be filed on October 4, 2007:
8 Whether Mr. Kayne is somehow precluded, by virtue of having contended (in
9 separate proceedings before Judge Pannell of the U.S. District Court for the
10 Northern District of Georgia) that no agreement *was ever formed* between TKC and
11 Mr. Kayne that included an arbitration provision where: (a) The question of
12 whether Mr. Kayne formed an agreement with TKC (issues of offer, acceptance and
13 consideration) is *separate* from whether the arbitration clause in that agreement is
14 or was *unconscionable*; (b) Mr. Kayne's complaint expressly disavows any intention
15 to "re-litigate" the issues presented to Judge Pannell; and (c) In any event, the
16 Ninth Circuit's *en banc* decision in *Nagrampa* was not issued until *after* Mr. Kayne
17 had presented his other arguments (based on pre-*Nagrampa* law) to Judge Panel.
18 [Answer: NO.]

19 **C. Balancing of Harm for Purposes of Injunctive Relief:** Whether
20 plaintiff David Kayne's motion for a temporary restraining order and preliminary
21 injunction should be granted where: (a) Plaintiff has a strong case on the merits,
22 based on *Nagrampa* and the circumstances, terms and effect of TKC's arbitration
23 clause; (b) Mr. Kayne faces possible irreparable harm if TKC is permitted to pursue
24 its "expedited" arbitration "hearing" on October 16; (c) TKC, by contrast, will suffer
25 no apparent harm if it is required to wait a few more days or weeks before pursuing
26 its purported claim against Mr. Kayne (which allegedly arose in 2002) in an
27 appropriate forum (a court) and under appropriate rules providing minimum due
28

1 process rights to Mr. Kayne; and (d) The requested injunctive relief will simply
2 preserve the *status quo* so that this Court can consider and rule on Mr. Kayne's
3 complaint before the TKC "arbitration" occurs. [Answer: YES.]

4 **II. STATEMENT OF RELEVANT FACTS**

5 **A. Summary of Relief Requested:**

6 Plaintiff David Kayne ("Mr. Kayne") seeks a temporary restraining order and
7 preliminary injunction to prevent defendant The Kinkade Company ("TKC") from
8 enforcing an unconscionable and unlawful "expedited" arbitration provision
9 contained in certain franchise agreement documents signed by Mr. Kayne.

10 The Complaint does not seek to contest the validity or enforceability of TKC's
11 "Application for Credit" and "Personal Guaranty" documents in their entirety.
12 Instead, it asserts that the arbitration provision set out in the "Application for
13 Credit" (which TKC seeks to apply through the "Personal Guaranty") is
14 unconscionable, and therefore unenforceable, under the standards recently
15 articulated in the Ninth Circuit's *en banc* decision in *Nagrampa v. Mailcoups, Inc.*,
16 469 F.3d 1257 (9th Cir. 2006) ("*Nagrampa*"). The provisions at issue here – which
17 would require Mr. Kayne to travel across the United States to try to defend against
18 a claim for over \$1.15 million in a forum where he has no right to call and cross-
19 examine witnesses or conduct discovery – clearly are unconscionable under
20 *Nagrampa* and other recent decisions. See the Complaint on file herein and the
21 Declaration of David Kayne ("Kayne Dec.") verifying the factual allegations of the
22 Complaint. See also, the Declaration of Charles L. Coleman ("Coleman Dec.")
23 accompanying this memorandum, authenticating various documents in this matter.

24 Because TKC intends to proceed with the October 16 arbitration "hearing" in
25 the absence of injunctive relief from this Court, Mr. Kayne seeks either: (a) A
26 temporary restraining order preventing Mr. Kayne from proceeding further with
27 the arbitration, coupled with an expedited hearing on a preliminary injunction
28

1 within ten (10) days thereafter; or (b) If a temporary restraining order is not issued,
2 a preliminary injunction to be issued based on a hearing to be conducted on October
3 5, 2007 (based on TKC's anticipated October 4 motion filing), or on such other date
4 as the Court may determine on or before October 15, 2007 (the day before TKC's
5 "expedited" arbitration is set to occur).

6 **B. Background Facts**

7 David Kayne ("Mr. Kayne") is the founder, President and (along with his
8 wife, Tracy) the principal shareholder of his family owned art gallery, Kayne Art
9 Galleries of Georgia, Inc. ("KAG"), a Georgia Corporation. Complaint, ¶ 9; Kayne
10 Dec., ¶¶ 3, 4. KAG was founded in order to market Thomas Kinkade art work and
11 reproductions in the Atlanta area. *Id.* The Thomas Kinkade Company ("TKC")
12 controls, distributes, and markets Thomas Kinkade artwork and TKC-
13 manufactured reproductions through a nationwide network of dealers. Complaint,
14 ¶ 10; Kayne Dec., ¶ 3. The authorized dealers are categorized based on the volume
15 of artwork and TKC-manufactured reproductions the dealer would purchase from
16 TKC to sell to customers. *Id.*

17 Mr. Kayne was encouraged by TKC to become a TKC authorized dealer of the
18 highest level, a "Signature Dealer." Complaint, ¶ 11; Kayne Dec., ¶ 3. As an
19 enticement to sign up as a "Signature Dealer," TKC offered Mr. Kayne, and other
20 potential dealers of this level, exclusive territories in which to sell the products,
21 exclusive marketing opportunities, incentives such as cash and prizes, and other
22 purported benefits. *Id.* These inducements were explained and offered to those who
23 attended TKC's motivational "training" sessions. Mr. Kayne attended one such
24 "training" session at TKC's headquarters in Santa Clara County, California, where
25 TKC encouraged and induced Mr. Kayne to become a "Signature Dealer."
26 Complaint, ¶¶ 12-13; Kayne Dec., ¶ 3.

TKC represented to Mr. Kayne and other prospective and actual dealers that the company adhered to certain "Christian values" of Thomas Kinkade and further represented to Mr. Kayne and other dealers that they would be dealing with TKC in an atmosphere of mutual trust and respect. Complaint ¶12; Kayne Dec., ¶ 3. TKC often referred to its dealers as its "partners." *Id.* Based on representations regarding the company's "trustworthiness," Mr. Kayne refrained from scrutinizing the agreement documents to the extent he normally would have in other business ventures. *Id.*

Based on TKC's representations, Mr. Kayne was induced to sign, and did sign on behalf of KAG, a series of standard form "Dealer Agreements" prepared by TKC (then operating as "Media Arts Group, Inc."). Complaint, ¶12 and Exhibit "B" thereto; Kayne Dec., ¶3. The Dealer Agreements required KAG to purchase at least \$100,000 of art inventory per dealer location from TKC in the first year of the agreements and also required an achievement of at least \$200,000 in retail sales per dealer location in the first year. Both of these requirements were subject to adjustment in later years "according to a formula applied to every Signature Gallery." Complaint, ¶ 13 and Exhibit "B"; Kayne Dec., ¶ 3.

TKC and KAG entered into Dealer Agreements in 1999-2000. Complaint, ¶14; Kayne Dec., ¶ 3. In or about October 2001, after the Dealer Agreements were entered into, TKC presented Mr. Kayne with TKC's standard form "Application for Credit" (hereinafter "Application") and "Personal Guaranty" (hereinafter "Guaranty"). *Id.*; Complaint, Exhibit "A". Embedded in the Application and referred to by reference in the Guaranty is the "expedited" arbitration provision that TKC now seeks to apply against Mr. Kayne, and which is the subject of the Complaint in this case. *Id.* The "expedited arbitration" provision states:

DISPUTES: ANY DISPUTE OR CONTROVERSY ARISING FROM THIS AGREEMENT WILL BE RESOLVED BY ARBITRATION BY THE AMERICAN ARBITRATION ASSOCIATION AT SANTA CLARA COUNTY, CALIFORNIA. THE LANGUAGE OF THE ARBITRATION SHALL BE ENGLISH. THE NUMBER OF THE ARBITRATORS SHALL BE ONE. THE PARTIES AGREE THE AMERICAN ARBITRATION ASSOCIATION'S EXPEDITED RULES SHALL APPLY **AND THEY WAIVE ALL RIGHT TO ANY HEARING REQUIRING WITNESS PRODUCTION. THE ARBITRATOR SHALL ISSUE AN AWARD BASED UPON THE WRITTEN DOCUMENTARY EVIDENCE SUPPLIED BY THE PARTIES.** THE ARBITRATOR'S AWARD SHALL BE BINDING AND FINAL. THE LOSING PARTY SHALL PAY ALL ARBITRATION EXPENSES, INCLUDING ALL ATTORNEY'S FEES. *[Italics and bold added]*.

Id. The "Personal Guaranty", which accompanied the Application, states that "[a]s Guarantor, [Mr. Kayne] is also bound by the above arbitration clause." *Id.*

TKC is a California-based business that is subject to the California Franchise Investment Law (Cal. Corps. Code §§ 31000, *et seq.*) and corresponding federal regulations promulgated by the Federal Trade Commission (46 C.F.R. Part 436), but KAG never provided the required disclosures to Mr. Kayne or his family-owned company (Kayne Art Galleries of Georgia, Inc., or "KAG"); had it done so, Mr. Kayne would not have signed the "Personal Guaranty" or the "Application for Credit" See Complaint, ¶¶ 15-29; Kayne Dec., ¶ 3.

After Mr. Kayne was induced to have KAG become a Signature Dealer and to subsequently sign the KAG "Application for Credit" and accompanying "Personal Guaranty", the relationship between TKC and KAG (and Mr. Kayne) soured. The relationship between the parties deteriorated because the high volume art business that TKC required and encouraged its Signature Dealers (including KAG) to develop proved to be increasingly unprofitable. Complaint, ¶ 33; Kayne Dec., ¶ 3. KAG and other Signature Dealers became disillusioned with the business model that had been sold to them by TKC without adequate and detailed disclosures. *Id.* The parties then engaged in a series of legal disputes in which TKC pursued KAG, and Mr. Kayne personally, for debts allegedly resulting from KAG's inability to sell

1 the large volume of TKC artwork required under TKC's "Signature Dealer"
2 agreements.²

3 Nearly five years after Mr. Kayne signed the "Personal Guaranty," TKC filed
4 a demand for arbitration with the American Arbitration Association, invoking the
5 "expedited" arbitration procedures set out the Application and referred to by
6 reference in the Guaranty. Kayne Dec., ¶¶ 3, 8 and Exhibit 2 thereto (Arbitration
7 demand). TKC thereafter increased and supplemented its claim to over \$1.15
8 million. Coleman Dec. ¶ 3 and Exhibit 2 thereto. At no time has TKC or its counsel
9 indicated that TKC has agreed to waive the draconian limitations on the scope of
10 the arbitration it is seeking to conduct under the arbitration clause at issue as set
11 out in Exhibit "A" to the Complaint. Declaration of Charles L. Coleman in Support
12 of Motion To Shorten Time, ¶ 4. In this motion, Mr. Kayne seeks injunctive relief to
13 prevent this unconscionable arbitration clause from being applied against him.

14 **III. ARGUMENT AND LEGAL AUTHORITIES**

15 **A. The District Court Is the Proper Forum for Mr. Kayne's Challenge** 16 **to the Enforceability of TKC's Unconscionable Arbitration Clause.**

17 As an initial matter, this Court is the proper venue for a determination of the
18 legality of the arbitration provision contained in the Application and allegedly
19 incorporated by reference in the Guaranty. The *Nagrapa* decision recently held
20 that: "[w]hen the crux of the complaint is not the invalidity of the contract as a
21 whole, but rather the arbitration provision itself, then the federal courts must
22 decide whether the arbitration provision itself is invalid and unenforceable
23 pursuant to 9 U.S. C. § 2 of the FAA." *Nagrapa, supra*, 469 F.3d at 1264. Thus,
24 the Court must closely examine the Complaint to determine whether striking the
25 arbitration provision may affect the validity of the "Application for Credit" or

26
27 ² A summary of the parties' legal disputes is set out in the Complaint, ¶¶ 33-44, as
28 verified by Mr. Kayne in the Kayne Dec. at ¶ 3.

1 "Personal Guaranty" in their entirety. *See id.* When this is done, it is clear that the
2 facially and actually unconscionable "expedited" arbitration clause is severable from
3 the remaining terms of these documents. Similarly, in *Davis v. O'Melveny & Myers*
4 *LLC*, 485 F.3d 1066, at 1071-1072 (9th Cir. 2007), the court relied on *Nagrampa* in
5 stating that "whether . . . [the] arbitration clause is unconscionable is for the court to
6 decide." Thus, Mr. Kayne's Complaint is filed as a response to TKC's arbitration
7 demand because the arbitration clause itself is unconscionable, and this Court is
8 the right place to resolve that issue.

9 In response to TKC's effort to enforce its "expedited" arbitration clause, Mr.
10 Kayne's Complaint seeks declaratory and injunctive relief only as to the arbitration
11 provision and not as to the entirety of the "Application for Credit" and "Personal
12 Guaranty". Specifically, in the First Cause of Action, Mr. Kayne seeks a declaration
13 that the arbitration provisions of Exhibit A are unlawful, unconscionable,
14 unenforceable, and void as a matter of law, so that if TKC wishes to pursue Mr.
15 Kayne under the "Personal Guaranty", it must do so in a court of law, in which Mr.
16 Kayne will be afforded a full, fair and complete hearing and due process.
17 Complaint, ¶ 60. Alternatively, this cause of action requests that, in the event that
18 an award or other form of relief is given to TKC by the AAA arbitrator appointed
19 pursuant to Exhibit "A", David Kayne be entitled to a declaration that any such
20 award is unenforceable and void. Complaint, ¶ 61.

21 In his Second Cause of Action, Mr. Kayne asserts that TKC should be
22 preliminarily and permanently enjoined from pursuing this or any other arbitration
23 under the provisions of Exhibit "A", and (if necessary) enjoined from seeking to
24 enforce any arbitral award against Mr. Kayne that it might obtain in connection
25 with Exhibit "A". Complaint, ¶ 64. In the Third Cause of Action, Mr. Kayne seeks a
26 declaration that TKC's attempt to enforce the "expedited" arbitration provisions of
27 Exhibit A, or any award issued as a result thereof, is an "unlawful, unfair or
28

1 fraudulent business act or practice" within the meaning of California Unfair
 2 Competition Law. Complaint at ¶ 68. The Fourth and final Cause of Action
 3 requests a preliminary and permanent injunction enjoining TKC from pursuing this
 4 or any other arbitration under the provisions of Exhibit "A", as said provisions are
 5 unlawful and violate the California Unfair Competition Law as applied to Mr.
 6 Kayne. Complaint, ¶¶ 70-71. In this regard, Mr. Kayne's request for an injunction
 7 under the Unfair Competition Law is not subject to arbitration where it serves a
 8 public purpose. *Cruz v. Pacificare Health Systems, Inc.*, 30 Cal. 4th 303, 316 (2003).

9 Thus, because Mr. Kayne does not challenge or threaten in this proceeding to
 10 invalidate the contract as a whole, but rather, challenges the legality of the
 11 arbitration provision itself, *Nagrampa* instructs that this Court is "required to turn
 12 to California law to address [Mr. Kayne's] arguments regarding the
 13 unconscionability of the arbitration provision." *See Nagrampa, supra*, 469 F.3d at
 14 1271.

15 **B. Standard of Review**

16 The Ninth Circuit's well-established standard for a preliminary injunction
 17 requires that the moving party show either (1) a combination of probable success on
 18 the merits and the possibility of irreparable injury, or (2) that serious questions are
 19 raised and the balance of hardships tips sharply in favor of the moving party.³
 20 *Stuhlbarg Int'l Sales Co., Inc. v. John D. Brush and Co., Inc.*, 240 F.3d 832, 839-40
 21 (9th Cir. 2001) (internal citation omitted); *see also Arcamuzi v. Continental Air*
 22 *Lines, Inc.*, 819 F.2d 935, 937 (9th Cir. 2001). These standards are not two separate
 23 tests but, rather, outer reaches of a single continuum. *Stuhlbarg International*
 24 *Sales Co., supra*, 240 F.3d at 840; *International Jensen, Inc. v. Metrosound U.S.A.*, 4
 25

26 ³ Courts often also consider whether the public interest favors the issuance of the
 27 injunction. *See Southwest Voter Registration Ed. Project v. Shelley*, 344 F.3d 914,
 917-18 (9th Cir. 2003).

1 F.3d 819, 822 (9th Cir. 1993). They represent two points on a sliding scale in which
2 the degree of irreparable harm increases as the probability of success on the merits
3 decreases. *Big Country Foods, Inc. v. Board of Education*, 868 F.2d 1085, 1088 (9th
4 Cir. 1989).

5 As set forth in detail below, Mr. Kayne meets either prerequisite and should
6 be granted a preliminary injunction to prevent TKC from pursuing arbitration
7 under an unconscionable and unenforceable arbitration provision.

8 **C. There Is a Strong Likelihood That Mr. Kayne Will Succeed on the**
9 **Merits of His Complaint**

10 Mr. Kayne is required only to demonstrate the "irreducible minimum" that he
11 has a "fair chance of success on the merits" of his case. *Johnson v. California State*
12 *Board of Accountancy*, 72 F.3d 1427, 1429-30 (9th Cir. 1995); *see also Republic of the*
13 *Philippines v. Marcos*, 862 F.2d 1355, 1362 (9th Cir. 1988). It is well-established
14 that unconscionability is a generally applicable contract defense, which may render
15 an arbitration provision unenforceable. *Nagrampa, supra*, 469 F.3d at 1280
16 (internal citation omitted). California courts have extended the doctrine of
17 unconscionability to embrace franchise agreements. *Id.* at 1280. California law is
18 applied law to determine whether the arbitration provision at issue here is
19 unconscionable. *See id.*

20 In determining whether an agreement to arbitrate is "unconscionable" and
21 hence unenforceable, the prevailing California view is that a sliding scale should be
22 invoked whereby if strong evidence of procedural unconscionability is presented,
23 less evidence is necessary with respect to substantive unconscionability, and vice-
24 versa. *Nagrampa, supra*, 469 F.3d at 1280; *Gentry v. Superior Court.*, 42 Cal.4th
25 443, 64 Cal. Rptr. 3d 773, 793 (2007). There is strong evidence that the "expedited"
26 arbitration provision at issue here is both procedurally and substantively
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unconscionable, and will ultimately be declared void and unenforceable under California law. *See* Complaint and Kayne Dec., ¶ 3.

1. The Arbitration Provision Is Procedurally Unconscionable

a. The Arbitration Agreement Is a Contract of Adhesion

The threshold inquiry in California's unconscionability analysis is "whether the arbitration agreement is adhesive." *Nagrampa, supra*, 469 F.3d at 1281. An adhesive contract is defined as a standardized contract, imposed upon the subscribing party without an opportunity to negotiate the terms. *Id.* (citation omitted). Standards for procedural unconscionability are satisfied by a finding that the arbitration provision was presented on a take-it-or-leave-it basis and that it was oppressive due to an inequality in bargaining power that resulted in no real negotiation and an absence of meaningful choice. *Id.* Courts have found that ordinary contracts of adhesion, although they are indispensable facts of modern life that are generally enforced, contain a degree of procedural unconscionability even without any notable surprises, and "bear within them a clear danger of oppression and overreaching." *Gentry, supra*, 64 Cal. Rptr. at 793 (citation omitted).

Here, Mr. Kayne was presented with the arbitration provision embedded in a take-it-or leave it, standard contract of adhesion entitled "Application for Credit" which was drafted entirely by TKC. Mr. Kayne was provided with no real opportunity to negotiate the terms of the arbitration provision. Complaint, ¶¶ 30-31 Kayne Dec. at ¶ 3. Furthermore, Mr. Kayne, on behalf of KAG, was in a substantially weaker bargaining position than TKC.

TKC's agreements were part of what was, in fact, a franchise relationship, although TKC did not provide the required disclosures. Complaint, ¶¶ 15-29; Kayne Dec. ¶ 3. Franchise agreements have some characteristics of adhesion because of the "vastly superior bargaining strength" of the franchisor. *See Nagrampa, supra*, 469 F.3d at 1282 (citation omitted). In addition to KAG's status

1 as TKC's franchisee, TKC was an existing creditor of KAG, which had signed Dealer
 2 Agreements obliging KAG to continue to purchase hundreds of thousands of dollars
 3 of TKC's mass-produced reproductions as inventory. Complaint, ¶ 13-14, 30-32.

4 **b. TKC Failed To Make Disclosures to Mr. Kayne as**
 5 **Required by California and Federal Franchise Law.**

6 An important factor in the procedural unconscionability analysis is the
 7 manner in which the contract or the disputed clause was presented or negotiated.
 8 *Nagrampa, supra*, 469 F.3d at 1282. Procedural unconscionability focuses on the
 9 factors of surprise and oppression, with surprise being a function of the reasonable
 10 expectations of the weaker party. *Higgins II v. Super. Ct.*, 140 Cal. App. 4th 1238,
 11 1249 (2006); *see also Nagrampa, supra*, 469 F.3d at 1280. Surprise involves the
 12 extent to which the supposedly agreed-upon terms of the bargain are hidden in the
 13 prolix printed form drafted by the party seeking to enforce the disputed terms
 14 *Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778, 783 (9th Cir. 2002).
 15 Oppression arises from an inequality of bargaining power which results in no real
 16 negotiation and an absence of meaningful choice. *Id.*

17 Mr. Kayne has strong evidence of both surprise and oppression. Mr. Kayne
 18 was presented with an adhesive contract and was not specifically informed of the
 19 existence of the arbitration provision. Kayne Dec., ¶12. The provision is buried in a
 20 two page document entitled "Application for Credit," and contains no clear
 21 indication or heading regarding an agreement to arbitrate. Complaint, Exh A.;
 22 Kayne Dec. ¶ 3. The agreement to arbitrate in the "Personal Guaranty" section is
 23 even less conspicuous. Mr. Kayne is supposedly required to submit to the
 24 "expedited" arbitration provision contained in the prior section by virtue of a single
 25 sentence in the Guaranty: "As Guarantor, I am also bound by the above arbitration
 26 clause." This sentence apparently incorporates the preceding "expedited"
 27 arbitration provision which includes no signal or heading identifying the provision
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1 as an arbitration agreement. Mr. Kayne was certainly surprised, five years after
2 signing the document, to learn that not only did KAG agree to arbitrate in a
3 particular manner, but that he was personally obligated to do so as well.
4 Complaint, ¶ 31, Kayne Dec. ¶3.

5 The arbitration provision also is unduly oppressive due to the manner in
6 which it was presented. Specifically, TKC failed to provide applicable disclosures as
7 required by California and Federal Franchise laws and regulations, which rendered
8 Mr. Kayne unable to make an informed decision regarding the arbitration provision
9 itself.

10 Pursuant to the California Franchise Investment Law ("CFIL") set forth in
11 California Corporations Code §§ 31000, *et seq.*, TKC was required to, but did not,
12 make detailed disclosures to KAG and/or to Mr. Kayne on a wide variety of subjects
13 specified in the Uniform Franchise Offering Circular ("UFOC"), prescribed by the
14 California Commissioner of Corporations, and pursuant to the CFIL. Complaint,
15 ¶¶ 17-18, 21-22; Kayne Dec. ¶ 3. Prior to signing the Application containing the
16 "expedited" arbitration provision, neither Mr. Kayne nor KAG received any
17 disclosures detailing the financial details of the Dealer Agreement arrangement, the
18 Application or the Guaranty. *Id.* At no point in time during the parties'
19 relationship did TKC provide Mr. Kayne or KAG with the required disclosures. *Id.*

20 Pursuant to federal franchising regulations (16 C.F.R. Part 436—"Disclosure
21 Requirements and Prohibitions Concerning Franchise"), promulgated by the
22 Federal Trade Commission ("FTC") under the Federal Trade Commission Act (15
23 U.S.C. §§ 41-58), and specifically under 16 C.F.R. Part 536, TKC was required to,
24 but did not, make detailed financial disclosures to KAG and/or to Mr. Kayne about
25 the Dealer Agreement arrangement as well as the Application and the Guaranty.
26 Complaint, ¶¶ 27-29; Kayne Dec., ¶ 3. Notably, "item 17.u" and "17.v" of the
27 "Disclosure Items" required under 16 C.F.R. § 436.5 called for explicit disclosures by
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TKC of the dispute resolution and forum provisions of any agreements it entered into with franchisees and their principals. Prior to signing the Application and Guaranty containing the "expedited" arbitration agreement, neither Mr. Kayne, nor KAG received any disclosures detailing the financial details of the Dealer Agreement arrangement, the Application, or the Guaranty contained therein. Complaint, ¶¶ 27-29, Kayne Dec. § 3.

Thus, the manner in which Mr. Kayne was presented with the "expedited" arbitration provision, was procedurally improper and fraught with oppression due to the fact that Mr. Kayne was not provided with the disclosures that both federal and California law require. These failures prevented Mr. Kayne, as a franchisee in a substantially weaker bargaining position and without an opportunity to negotiate, from making an informed decision regarding the arbitration provision contained in the "Credit Application" and "Personal Guaranty". These franchise-related issues merely exacerbated the independently-sufficient procedural unconscionability that attended the presentation and execution of the "Application for Credit" and "Personal Guaranty".

At the time he signed the Application on behalf of KAG and the Guaranty in 2001, it was not within Mr. Kayne's reasonable expectations that, five or six years later, without extending any additional credit to KAG or any separate credit to Mr. Kayne, or even manifesting its "acceptance" of the Application, TKC would now assert that it is entitled to conduct a "no witness," "no discovery" mini-hearing in California that court result in Mr. Kayne facing an award against him personally for more than one million dollars. Complaint, ¶ 31, Kayne Dec. ¶ 3.

2. The Arbitration Provision Is Substantively Unconscionable.

An arbitration provision is substantively unconscionable if it is overly harsh or generates one-sided results. *Armendariz v. Foundation Health Psychcare Services Inc.*, 24 Cal. 4th 83, 114 (2000). In this case, the "expedited" arbitration

1 provision heavily favors the drafter, TKC. It states that the parties must agree to
2 the AAA's "expedited rules," yet simultaneously requires the franchisee to agree to
3 substantive modifications to the rules themselves, without any notice to the
4 franchisee as to how the "expedited rules" have been modified. For example, Rule
5 E-6 states:

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7 *Where no party's claim exceeds \$10,000, exclusive of interest and arbitration*
8 *costs, and other cases in which the parties agree, the dispute shall be*
9 *resolved by submission of documents, unless any party requests an oral*
10 *hearing, or the arbitrator determines that an oral hearing is necessary. The*
11 *arbitrator shall establish a fair and equitable procedure for the submission of*
12 *documents. [Italics added].*

13 Coleman Dec., ¶ 2 and Exhibit 1 thereto. The plain language of Rule E-6 indicates
14 that the Rule was intended for claims that are less than \$10,000, while the amount
15 in controversy here is now over \$1.15 million. Coleman Dec. ¶ 3 and Exhibit 2
16 thereto. Similarly, the "expedited" arbitration provision requires a waiver of "all
17 right to any hearing requiring witness production," and that the award will be
18 based strictly "upon the written documentary evidence supplied by the parties."
19 Yet, Expedited Rule 6 clearly states that a party can request an oral hearing, with
20 no restrictions as to witness production.

21 It is a matter of business common sense that the "expedited" documents-
22 only rules contemplated by the AAA are intended for commercial disputes between
23 merchants where the only question presented is an accounting for invoices and
24 receipts in amounts so small as to make it uneconomical to have a full-blown
25 hearing on the subject. This is a far cry from the use to which TKC now seeks to
26 put the clause that it drafted. TKC seeks over \$1.15 million from a small Georgia
27 business owner that hotly disputes TKC's claim and has a number of defenses that
28 will be precluded by the application of the "expedited" procedures. Kayne Dec. ¶ 12.

As was foreseeable when it induced people to sign its agreements, TKC's
provision containing the modified "expedited rules" heavily favors TKC, whose

1 position is simply "pay up and don't argue". No explanation for these restrictions,
2 which remove all notion of basic fairness and due process from the proceeding, can
3 be found in the documents and no explanation was given orally to Mr. Kayne. See
4 Complaint, ¶ 31 and Kayne Dec., ¶¶ 3, 12. Similarly, only a legally sophisticated
5 party could have possibly understood that the modified "expedited" rules were
6 considerably less favorable to Mr. Kayne than those set forth in AAA's Commercial
7 Rules designed for million-dollar disputes. Moreover, "even experienced but legally
8 unsophisticated businessmen may be unfairly surprised by unconscionable contract
9 terms." *Gentry, supra*, 64 Cal. Rptr. at 795 (citing *Stirlen v. Supercuts, Inc.*, 51 Cal.
10 App. 4th 1519, 1535 (1997)).

11 The arbitration provision also contains a forum selection clause, which
12 requires the arbitration to take place in Santa Clara County, California, TKC's
13 principal place of business. Complaint, Exhibit "A"; Kayne Dec. ¶ 3 and Exhibit 1
14 thereto. To assess the reasonableness of "place and manner" provisions in an
15 arbitration clause, the respective circumstances of the parties are considered.
16 *Nagrampa, supra*, 469 F.3d at 1288. Here, the parties' bargaining positions were
17 unequal, which resulted in an oppressive contract of adhesion, containing a forum
18 selection clause. The forum selection clause requires Mr. Kayne, a citizen of
19 Georgia, to travel thousands of miles across the country to California, while TKC
20 has a minimal travel burden, if any, as its principal place of business is within the
21 same county as the selected forum. Mr. Kayne, along with other small franchisees
22 located outside of California, must incur additional traveling and living expenses
23 and increased costs associated with having counsel familiar with California law.

24 Similar to the forum selection clause at issue in *Nagrampa*, the forum
25 selection clause here "has no justification other than as a means of maximizing
26 advantage over [franchisees]." *Nagrampa, supra*, 469 F.3d at 1289-90. TKC could
27 have reasonably expected that the selected forum in California would have
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effectively precluded out of state franchisees, including KAG and Mr. Kayne, from asserting claims and defenses against it due to burdens and expenses that the forum selection places on small business owners. *See id.* at 1290.

Mr. Kayne has presented substantial evidence supporting his claim that the arbitration provision is unconscionable. *See* Complaint, Exhibit "A" thereto, and the Kayne Dec. As alleged in the Complaint, "an unconscionable contract amounts to an unfair business practice under Business and Professions Code Section 17200." *See In re First Alliance Mortgage Co*, 280 B.R. 246, 251 (C.D. Cal. 2002). Thus, Mr. Kayne has demonstrated a strong likelihood of success on the merits of the Complaint.

D. Mr. Kayne Will Suffer Immediate, Irreparable Injury If Injunctive Relief Is Denied.

In addition to demonstrating a "fair chance of success" on the merits of his Complaint, Mr. Kayne also can demonstrate a significant threat of irreparable injury warranting injunctive relief. *See Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716, 725 (9th Cir. 1999). Such harm must be immediate or imminent. *Caribbean Marine Serv. Co. v. Baldridge*, 844 F.2d 668, 674 (9th Cir. 1988); *Midgett v. Tri-County Metro. Transp. Dist. of Oregon*, 254 F.3d 846, 850-51 (9th Cir. 2001).

In this case, TKC has already noticed and demanded the "expedited" arbitration. An arbitrator has been appointed, and the "hearing" is set to occur on October 16, 2007. Coleman Dec., ¶ 7 and Exhibit 6 thereto. Mr. Kayne is faced with the immediate and untenable position of either waiving his *Nagampa*-based objections to the arbitration or succumbing to an unconscionable arbitration procedure where he will be forced to forfeit all rights to meaningful discovery, witness testimony, and cross-examination in an unfavorable forum. Mr. Kayne has several substantial defenses regarding the claims that TKC is asserting against him. Kayne Dec., ¶ 12. In order to establish these defenses, however, Mr. Kayne

1 must be allowed the basic due process rights of conducting meaningful discovery,
2 calling and cross-examining witnesses. *Id.*

3 If the arbitration is allowed to proceed under the unconscionable arbitration
4 provision, Mr. Kayne will be subjected to an arbitration procedure where he will be
5 deprived of the right to present an adequate defense. Exhibit A declares that such
6 an award would be "binding and final." Accordingly, while Mr. Kayne retains the
7 right to challenge any arbitral award resulting from the hearing based on
8 *Nagrapa* and other recent case law (such as *Gentry*) dealing with the
9 unconscionability of the arbitration clause, he has a significant and legitimate
10 interest in determining *before* the arbitration occurs whether it is unconscionable.

11 **E. The Balance of Harms Tips Sharply in Mr. Kayne's Favor.**

12 Where plaintiff shows a strong likelihood of success on the merits and a
13 threat of irreparable harm, an order granting a preliminary injunction need not
14 reach the balance of hardships. Indeed, "[i]f the balance of harm tips decidedly
15 toward the plaintiff, then the plaintiff need not show as robust a likelihood of
16 success on the merits as when the balance tips less decidedly. *State of Alaska v.*
17 *Native Village of Venetie*, 856 F.2d 1384, 1389 (9th Cir. 1988). As demonstrated
18 above, Mr. Kayne is highly likely to succeed on the merits of his case, and certainly
19 has at least a "fair chance" of success. Even if the Court determines that the
20 likelihood of his success is less than "strong" and continues to the balancing of
21 hardships analysis, the balance tips decidedly in Mr. Kayne's favor.

22 **1. TKC Will Suffer Little or No Irreparable Harm if A**
23 **Preliminary Injunction is Granted**

24 In contrast to the immediate and irreparable harm Mr. Kayne will suffer
25 should the "expedited" arbitration proceed, TKC faces no potential harm which
26 cannot later be reconciled or vindicated if a preliminary injunction is granted.
27 Should the court ultimately determine that the "expedited" arbitration provision is
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1 in fact lawful and enforceable, TKC can promptly reschedule the proceeding to take
2 place on an "expedited" basis. TKC has adequate and available remedies for any
3 delay and can seek (and is seeking) interest on any monetary award that it may
4 ultimately receive, if any. Moreover, TKC has demonstrated that time is not "of the
5 essence" as the "Personal Guaranty" has been in effect for several years, but TKC
6 has just recently decided to pursue Mr. Kayne under this premise. *See* Complaint,
7 ¶42, Kayne Dec., ¶ 3, Coleman Dec., ¶ 3 and Exhibit 2 thereto (containing TKC's
8 assertion that the underlying "debt" being pursued was incurred in 2002). Any
9 incremental delay in the scheduling of the arbitration until the completion of Mr.
10 Kayne's lawsuit will not bring TKC any significant harm.

11 **2. Public Policy Favors A Preliminary Injunction**

12 As codified in California Civil Code sections 1667 and 1670.5, California has
13 a strong public policy against the enforcement of illegal contracts or unconscionable
14 clauses contained in contracts. Therefore, it is in the interest of the general public
15 that this Court determine the legality of the "expedited" arbitration provision.
16 Similarly, it is in the public's interest that TKC not be allowed to exercise or enforce
17 the provision embedded in its form contracts against Mr. Kayne, other franchisees,
18 or the general public, until a full adjudication regarding the legality of the provision
19 has been completed.

20 **IV. CONCLUSION**

21 *Nagrampa* and its progeny now make it clear that it is for the courts, and not
22 the arbitrator, to determine whether an arbitration clause is unconscionable and
23 hence unenforceable. If the clause is unconscionable, so too is the result of any
24 arbitral award resulting from the application of such a clause over the timely
25 objection of the adversely affected party.

26 Mr. Kayne has a strong interest in confirming, *before* the arbitration occurs,
27 whether the facially-unconscionable "expedited" procedures in TKC's clause will be
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1 deemed to pass muster under *Nagrampa*, *Davis*, *Gentry* and other recent cases in
2 California and the Ninth Circuit addressing this issue. TKC will necessarily have
3 to face this issue sooner (before the arbitration) or later (after it seeks to confirm
4 any arbitral award) based on the tainted "expedited" procedure. TKC can claim no
5 real prejudice by having the issue presented and resolved now rather than later.

6 For each of the reasons identified above, Mr. Kayne respectfully requests that
7 this Court grant his motion for a temporary restraining order and preliminary
8 injunction. Proposed forms of order accomplishing this are filed concurrently with
9 this motion.

10 Dated: October 1, 2007

Respectfully submitted,

11 HOLLAND & KNIGHT LLP

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